

OFFICE OF LEGISLATIVE RESEARCH & GENERAL COUNSEL



MICHAEL E. CHRISTENSEN
Director

M. GAY TAYLOR
General Counsel

Utah State Capitol Complex
House Building, Suite W210
PO Box 145210
Salt Lake City, Utah 84114-5210

(801) 538-1032 • fax 538-1712
<http://le.utah.gov>

MEMORANDUM

TO: Utah Tax Review Commission ("TRC")

FROM: Rebecca L. Rockwell, Associate General Counsel
Mitchell Park, Law Clerk

DATE: June 15, 2007

SUBJECT: Constitutionality of Adopting Federal Law and Amendments by Reference in Legislation

Background Information:

At the June 1, 2007, meeting of the TRC's working group on sales and use taxes ("working group"), the working group endorsed submitting to TRC for discussion two options relating to the taxation of business inputs. The first option creates a sales and use tax exemption for business inputs. The second option removes business inputs from the sales and use tax base.

A common feature of both options is that "business inputs" is defined by reference to certain items under the Internal Revenue Code ("IRC") that are deductible for federal income tax purposes. The working group discussed whether these IRC provisions should be referenced as of a date certain or whether the provisions should incorporate any subsequent amendments made by Congress to those IRC provisions that would affect the deductibility of those items ("subsequent amendments proposal"). The working group expressed a preference for the subsequent amendments proposal for several reasons including:

- many taxpayers that purchase, lease, or rent tangible personal property that would qualify as a business input under the above options also claim the income tax deductions allowed by the IRC provisions referenced in the sales and use tax definition of "business inputs"; and
- tax simplicity favors a policy of consistency between the federal and state provisions to prevent a taxpayer from being subject to two sets of rules, a static set of state rules and a changing set of federal rules, that could become increasingly divergent over time.

Working group members also expressed concerns that referring to a date certain raises issues of knowing obsolete federal law and may deprive a taxpayer of the use of an evolving set of materials that are helpful in interpreting IRC provisions.

Question Presented:

The working group asked staff to evaluate whether the subsequent amendments proposal could be drafted in a manner that does not violate constitutional principles governing the delegation of legislative powers.¹

Short Answer:

Although there is no binding legal precedent addressing the constitutional permissibility of incorporating IRC provisions and subsequent amendments by reference in Utah sales and use tax statutes, the subsequent amendments proposal could likely be drafted in a manner analogous to a Utah Supreme Court case that upholds the adoption of federal law and subsequent amendments by reference. The subsequent amendments proposal may be more closely analogized to this case if the legislation:

- delegates rulemaking authority to the Utah State Tax Commission ("Tax Commission") to incorporate the IRC provisions and subsequent amendments;
- establishes standards to guide the Tax Commission in promulgating those administrative rules; and
- provides for adequate notice of changes in IRC provisions to taxpayers and the Legislature.

In addition, there are policy arguments in favor of upholding legislation codifying the subsequent amendments proposal. These arguments include:

- Utah has a pattern of relying on federal law in the calculation of state taxes;
- consistency between state and federal law promotes simplicity for taxpayers in calculating and filing taxes;
- if the IRC provisions that are incorporated by reference change, the change does not thwart the underlying policy goal of the Legislature to promote simplicity for taxpayers in calculating and filing taxes;
- taxpayers routinely receive notice of changes in IRC provisions when they file state and federal tax forms and returns, which provide instructions and reference other interpretive information; and
- there is precedent for the Utah State Tax Commission ("Tax Commission") to report changes in IRC provisions to the Legislature.

¹ An additional issue under the Utah Constitution could potentially arise under Article XIII, § 4(2)(a), which provides that, "[i]n a statute imposing an income tax, the Legislature may . . . define the amount on which the tax is imposed by reference to a provision of the laws of the United States as from time to time amended . . ." The language of this provision does not *specifically* grant the Legislature permission to refer to the laws of the United States to define the amount on which a tax is imposed if that tax is not an income tax, nor does this provision preclude such a reference. There is no case law interpreting this constitutional provision.

Overview of Case Law:

Delegation of Legislative Authority

Utah Constitution Article VI, Section I, provides that the legislative power of the State shall be vested in the Legislature. The Utah Supreme Court has held that the Legislature is allowed to delegate some of its power so long as certain conditions are met. First, the "Legislature is not permitted to abdicate or transfer to others the essential legislative function with which it is thus vested"² Second, if an essential legislative function is not involved, any delegation made by the Legislature "must be accompanied by a declared policy outlining the field within which such rules and regulations may be adopted."³ If these conditions are met, the delegation of legislative authority is upheld.

The first inquiry in determining the permissibility of a delegation of legislative authority is whether the delegation is of an "essential legislative function."

The Utah Supreme Court has found several legislative functions to be essential. For example, in *Western Leather & Finding Co. v. State Tax Comm'n*, the Court held that the imposition of a tax and the designation of those who must pay the tax is an essential legislative function that cannot be transferred to others.⁴ Similarly, in *Tite v. State Tax Comm'n*, the Court held that while the Tax Commission had the power to hear and determine whether there was a violation of a particular tax law, the Legislature could not give the Tax Commission the power to determine the amount of tax penalties.⁵ More recently, the Court held that the Legislature cannot give the state Attorney General the authority to declare certain substances as controlled, nor the authority to promulgate criminal penalties associated with possession of those substances.⁶ Later, the Utah Court of Appeals held that similar authority could not be given to the United States Attorney General.⁷

The subsequent amendments proposal may be distinguished from the delegations that were found to be unconstitutional delegations of essential legislative functions in the above cases. These

² *Id.* at 687 (Utah 1977) (quoting *Western Leather and Finding Co. v. State Tax Comm'n*, 48 P.2d 526, 528 (Utah 1935)).

³ *Robinson v. State*, 2001 UT 21, ¶14, 20 P.3d 396 (Utah 2001) (quoting *Bird & Jex Co. v. Funk*, 85 P.2d 831, 834 (Utah 1939)).

⁴ 48 P.2d 526, 528 (Utah 1935).

⁵ 57 P.2d 734, 741 (Utah 1936).

⁶ *Gallion*, 572 P.2d 683 (Utah 1977).

⁷ *State v. Green*, 793 P.2d 912, 916 (Utah Ct. App. 1990).

cases hold that defining crime, establishing punishments, imposing taxes, establishing tax penalties, and other similar actions are essential legislative functions. In contrast, if the subsequent amendments proposal is adopted by the Legislature, the delegation is simply a codification of established legislative policy to rely on federal law as a basis for calculating state taxes and promoting simplicity for taxpayers in calculating and filing taxes by ensuring consistency between state and federal law.⁸

If an essential legislative function is not involved, a delegation made by the Legislature "'must be accompanied by a declared policy outlining the field within which such rules and regulations may be adopted.'"

In *Robinson v. State*, the Utah Supreme Court upheld a provision of the Utah Code that granted the Utah Department of Transportation ("UDOT") the authority to create administrative rules to comply with federal mandates for federal aid projects.⁹ Significantly, the Court found that the Legislature provided sufficient direction to UDOT when it allowed UDOT to adopt rules, which incorporated federal law by reference, that complied with the federal mandates. Because the statutory language was clear in determining "a legislative intent that UDOT enact rules to comply with federal mandates," and because the statutory language provided policy guidelines for UDOT to follow in making rules, the Court found that the Legislature delegated authority with enough specificity to be constitutional.¹⁰ Specifically, the Court held that, "[i]n light of the clear legislative policy of compliance with federal mandates in such a situation, the UDOT rule is not in conflict with Article VI, section 1, of the Utah Constitution. The power to make such a rule was properly delegated by the [L]egislature to UDOT."¹¹

Legislation adopting the subsequent amendments proposal could be drafted consistent with the statute upheld in *Robinson* to grant specific rulemaking authority to the Tax Commission to incorporate subsequent amendments to the IRC provisions used in defining "business inputs." This grant of authority is consistent with Utah's pattern of relying on federal law in the calculation of state taxes.¹² In addition, if adopted by the Legislature, the grant of authority would codify the legislative policy of promoting simplicity for taxpayers in calculating and filing taxes by ensuring consistency between state and federal law. Requiring the Tax Commission to

⁸ See, e.g., UTAH CODE ANN. § 59-2-201 (2007); UTAH CODE ANN. § 59-7-101 (2007); UTAH CODE ANN. § 59-7-102 (2007); UTAH CODE ANN. § 59-10-103 (2007); UTAH CODE ANN. § 59-10-104.1 (2007); UTAH CODE ANN. § 59-12-103 (2007); UTAH CODE ANN. § 59-12-104 (2007); UTAH CODE ANN. § 59-13-102 (2007).

⁹ *Robinson*, 2001 UT 21 at ¶28.

¹⁰ *Id.* at ¶17.

¹¹ *Id.*

¹² See *supra* note 9.

adopt relevant federal law changes would only serve to enhance, rather than negate, this legislative policy position.

Furthermore, the legislation could provide boundaries on the exercise of Tax Commission power through notice requirements. Public notice and hearing requirements are an integral part of the administrative rulemaking process. In addition, the legislation could require the Tax Commission to provide notice of federal law changes to taxpayers through interpretive materials and to the Legislature as is the practice in other matters of taxation.¹³

However, an argument could be made that by adopting the subsequent amendments proposal, the Legislature impermissibly delegates its authority to make substantive law to Congress. The United States District Court for the District of Utah held in *Utah League of Insured Sav. Ass'ns v. Utah*¹⁴ that a provision of the Utah Code that based state regulation of savings and loan firms on a prospective adoption of federal savings and loan association's rights was impermissible under Utah's constitution as an unconstitutional delegation of state lawmaking power to the federal government. Courts in other jurisdictions have made similar findings.¹⁵

Conclusion:

On balance, legislation could arguably be drafted incorporating the subsequent amendments proposal in a manner that does not violate constitutional principles governing the delegation of legislative powers. There are strong legal and policy arguments in favor of upholding such legislation. To increase consistency with case law, the legislation could include rulemaking authority expressly delegating the determination of which IRC provisions are incorporated to the Tax Commission, providing policy guidelines for making the determination, or requiring notice of relevant IRC changes to taxpayers and the Legislature.

¹³ See, e.g., UTAH CODE ANN. § 59-1-213 (2007) (requiring the Tax Commission to make an annual report to the Revenue and Taxation Interim Committee on or before the October interim meeting concerning the impacts of the reliance of Title 59 on the Internal Revenue Code). See also, UTAH CODE ANN. § 59-7-612(7) (2007); UTAH CODE ANN. § 59-7-613(7) (2007); UTAH CODE ANN. § 59-10-1012(6) (2007); UTAH CODE ANN. § 59-10-1013(7) (2007). See also, Utah State Tax Commission, "Tax Commission Research Library," available at <http://www.tax.utah.gov/research/>.

¹⁴ 555 F. Supp 664 (D. Utah 1983).

¹⁵ See, e.g., *Advocates for Effective Regulation v. City of Eugene*, 981 P.2d 368, 379 (Ore. Ct. App. 1999); *State v. Williams*, 583 P.2d 251 (Ariz. 1978); *Crowly v. Thornbrough*, 294 S.W.2d 62 (Ark. 1956); *Hutchins v. Mayo*, 197 So. 495 (Fla. 1940); *State v. Intoxicating Liquors*, 117 A. 588 (Maine 1922); *Warren v. State Constr. Code Com'n*, 239 N.W.2d 640 (Mich. Ct. App. 1976); *Cline v. Consumers' Cooperative Gas & Oil Co.*, 274 N.Y.S. 362 (N.Y. Sup. Ct. 1934).